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No. 73-306

IN THE

Supreme Court of the United States

October Term, 1973

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

BANGOR PUNTA CORPORATION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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September 13, 1973.

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This brief is submitted by respondent Bangor Punta Corporation ("Bangor Punta") in opposition to the petition for a writ of certiorari filed by the Securities and Exchange Commission ("Commission").

Questions Presented

1. Should the standard enunciated by this Court in *United States* v. *W. T. Grant Co.*, 345 U.S. 629, 633 (1953), that there must exist "some cognizable danger of recurrent violation" in order to grant permanent injunctive relief in enforcement actions commenced by governmental agencies, be abandoned?

2. Did the District Court abuse its discretion in this action by denying the Commission's request for permanent injunctive relief where the violation of the securities laws which was found to have occurred involved a unique factual situation and the defendant was found to have acted in complete good faith with no intent to violate the securities laws?

Statement of the Case

On May 29, 1969, Bangor Punta filed with the Commission a registration statement for an exchange offer to the shareholders of Piper Aircraft Corporation ("Piper"). Bangor Punta's registration statement became effective and its exchange offer opened on July 18, 1969. The offer closed on July 29, 1969 with Bangor Punta having acquired 111,628 Piper shares (approximately 7% of its outstanding stock).

At the time of its Piper exchange offer, one of Bangor Punta's assets was its ownership interest in approximately 98% of the outstanding stock of the Bangor and Aroostook Railroad Company ("BAR"). Although Bangor Punta's equity in the underlying net assets of the BAR was approximately $30 million, and it would have been customary for Bangor Punta to carry its BAR investment on the balance sheet at this figure, Bangor Punta had since 1965 used a carrying value of approximately $18.4 million based upon an independent market price evaluation of the BAR stock in 1965. This $18.4 million figure appeared on the balance sheet in Bangor Punta's registration statement for its Piper exchange offer, and an accompanying footnote to the balance sheet stated clearly that the BAR's carrying value was based upon the 1965 market price evaluation.* In addition, the registration statement also included complete separate financial statements for the BAR and a statement of earnings covering the five preceding years, which showed that the BAR's earnings had declined steadily from more than $1.6 million in 1965 (when the appraisal was made) to approximately $60,000 in 1968.

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* The footnote, which also fully described certain annual accounting adjustments to the BAR's carrying value, read as follows:

"NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Information Relating to March 31, 1969 is Unaudited)

NOTE 1—Principles of Consolidation:

. . .

At September 30, 1965, the equity in the underlying net assets of the Railroad amounted to $29,791,456, which was

During the period in which Bangor Punta's registration statement was required to be kept effective (July 18—August 27, 1969), Bangor Punta was studying various alternative methods of possible disposition of the BAR but had reached no decision concerning whether such disposition should occur, or the form of the disposition. Subsequently, on October 2, 1969, Bangor Punta entered into an agreement to sell its BAR stock to The Amoskeag Company ("Amoskeag") for $5 million plus certain additional contingent consideration, terms which were similar to those first proposed by Amoskeag in May, 1969. As a result of such sale, Bangor Punta recognized a book loss, not a cash loss, of approximately $13 million.

On September 9, 1970, the Commission filed its complaint in this action charging that Bangor Punta's registration statement was materially misleading by failing to state that

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$21,694,917 more than the then carrying value. Recognition of this excess was deemed appropriate but it was decided to limit the amount includible in stockholders' equity to $18,384,808 based upon a market price evaluation of the Railroad common stock. This resulted in increasing the carrying amount of the investment in the Railroad and stockholders' equity by $10,288,629. Such restated carrying amount of the investment was $11,406,648 less than the equity in underlying net assets. During the year ended September 30, 1966 the carrying amount of the investment increased by $749,983, representing the cost of 559 shares of capital stock acquired from minority holders and the equity in undistributed earnings for the year, to the amount of $19,134,791, or $11,449,312 less than the equity of $30,584,103 in the underlying net assets of the Railroad. During the year ended September 30, 1967 the carrying amount of the investment decreased by $336,488, representing the excess of dividends paid to the parent over the parent's equity in the earnings of the Railroad, to $18,798,303, or $11,451,123 less than the equity of $30,249,426 in the underlying net assets of the Railroad. During the year ended September 30, 1968 the carrying amount of the investment increased by $32,443, representing the cost of 120 shares of capital stock acquired from minority holders and the equity in undistributed earnings for the year, to the amount of $18,830,746, or $11,465,081 less than the equity of $30,295,827 in the underlying net assets of the Railroad. Separate financial statements of the Railroad are included elsewhere herein. . . ." (Exhibits in Court of Appeals, Vol. I, p. 99).

Bangor Punta had reached a decision, and made a commitment, to sell its BAR interest to Amoskeag for $5 million prior to July 18, 1969, but had intentionally deferred consummation of the transaction to avoid disclosure of the book loss in its registration statement. In addition to seeking an order requiring Bangor Punta to offer rescission to the former Piper shareholders who had accepted its exchange offer, the Commission sought injunctive relief against Bangor Punta, alleging that Bangor Punta had "demostrated a propensity for violating the securities laws" (SEC Complaint, Appendix in Court of Appeals, Vol. I, pp. 194A-200A).

In March, 1971, the action was tried before the Honorable Milton Pollack, District Judge for the Southern District of New York.*

In his opinion filed on August 25, 1971 (Jt. App. C-1-18),** Judge Pollack found that the Commission had wholly failed to prove the allegations of its complaint, *i.e.*, that Bangor Punta had reached a decision to sell the BAR and had deferred its consummation to avoid disclosure. Judge Pollack stated:

> "These contentions, as well as Dumaine's [the Commission's only witness] testimony on the subject, lack support both in the credible evidence and the probabilities. Indeed the evidence which the Court accepts as worthy of belief unequivocably negates any such purpose or plan.
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> * * * * *

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* The action was consolidated for trial with an action commenced by Chris-Craft Industries, Inc. ("Chris-Craft") against Bangor Punta and others (the "Chris-Craft action") and an action commenced by Bangor Punta against Chris-Craft (the "Bangor Punta action"), as all three actions related to the contest between Bangor Punta and Chris-Craft for control of Piper. There are presently pending before this Court three petitions for certiorari (Nos. 73-152, 73-153 and 73-154) filed by the defendants in the Chris-Craft action.

** "Jt. App." refers to the joint appendices filed in this Court by the petitioners in the Chris-Craft action (Nos. 73-152, 73-153 and 73-154).

> "The Court has found that as of these dates [July 18-August 27, 1969] Bangor Punta had not reached a decision to sell. The Commission's charge that the sale was a reasonable probability is made from the vantage point of hindsight. In the total perspective of events . . . the Court cannot find that the sale [of the BAR] was a reasonable probability at the time and to the people involved." (Jt. App. C-11, 13).

Although rejecting the Commission's contentions, Judge Pollack went on to rule that because of the unique appraisal nature of the $18.4 million carrying value of the BAR, Bangor Punta's registration statement was "unintentionally in error" in failing to disclose the "circumstances surrounding the negotiations for the sale of the BAR" even though a sale was not a reasonable probability at the time. (Jt. App. C-13-15, G-19).*

In so ruling, Judge Pollack stressed that Bangor Punta had acted in complete good faith, stating:

> "I find that Bangor Punta did not intentionally or purposefully mislead Piper Aircraft stockholders or the public or investors by the omission to make disclosure of the sale under consideration nor did Bangor Punta or its directors intend to gain an advantage over Chris-Craft by the non-disclosure in the contest being waged for control of Piper. There was no purposeful connection between the nondisclosure and the contest for control. In other words, the nondisclosure was not prompted by an improper purpose." (Jt. App. C-14).

Having determined that there was an error, albeit unintentional, in Bangor Punta's registration statement, Judge Pollack ordered that Bangor Punta make an offer of rescis-

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* The phrase "unintentionally in error" was used by Judge Pollack in his opinion in the companion Chris-Craft action to describe his holding in the instant action (Jt. App. G-19).

sion to those Piper shareholders who had accepted its exchange offer pursuant to such registration statement. However, because his ruling was expressly limited to this highly unique situation involving a carrying value based upon an appraisal and because he found that Bangor Punta had acted in good faith with no intent to mislead investors, Judge Pollack exercised his discretion to deny the Commission's request for injunctive relief. (Jt. App. C-14-16).

On appeal to the Second Circuit, Judge Pollack's decision in this action was affirmed in all material respects in an opinion dated March 16, 1973 (Jt. App. H-1-124).* With respect to his denial of the Commission's request for permanent injunctive relief, Judges Gurfein and Mansfield formed a majority in voting to affirm Judge Pollack (Jt. App. H-96-100, 117-124), and Judge Timbers dissented (Jt. App. H-78-89).

Argument

The District Court's denial of the Commission's request for permanent injunctive relief was a proper exercise of its discretion.

Contrary to the Commission's assertion in its petition herein, the decision in the instant case does not establish new and more stringent standards for the granting of injunctive relief in Commission enforcement actions.

Although the Commission recognizes the standard for the granting of injunctive relief which this Court enunciated in *United States* v. *W. T. Grant Co., supra,* that "there exists some cognizable danger of recurrent violation," it

* The Second Circuit's decision dealt not only with the instant action but with the related Chris-Craft and Bangor Punta actions. Although, in the Chris-Craft action, the Second Circuit also affirmed the District Court's determination that Bangor Punta had acquired some of its Piper shares in technical violation of Rule 10b-6, the Commission did not base its complaint on any claimed violation of Rule 10b-6 and has expressly disclaimed any reliance upon any violation of Rule 10b-6 as a basis for its claim for injunctive relief (Appendix in Court of Appeals, Vol. III, pp. 1113A-1114A).

argues that proof of a "significant violation" of the federal securities laws itself establishes a "cognizable danger of recurrent violation" requiring the issuance of an injunction "unless the defendant shows exceptional circumstances exist that would make an injunction inappropriate in the particular case."

In so contending, the Commission is attempting to eliminate the broad discretion resting with the district judge to determine whether, based on all the facts and circumstances in a particular case, a "cognizable danger of recurrent violation" does in fact exist. The district judge's discretion was expressly recognized by this Court in *Grant* when it stated:

> ". . . The chancellor's decision [whether to grant injunctive relief] is based on all the circumstances; his discretion is necessarily broad and a strong showing of abuse must be made to reverse it." 345 U.S. at 633.

As the facts detailed herein fully demonstrate, there is no basis for any claim that Judge Pollack abused his discretion by denying injunctive relief under the circumstances of the instant case. Indeed, even under the test which the Commission has proposed, the circumstances of the instant case are fully sufficient to fall within the "exceptional circumstances" which the Commission itself would recognize as a proper basis for denial of injunctive relief.

Prior to the instant case, no decided case imposed upon a corporation a duty to disclose a proposal to purchase an asset used in the operations of the company absent a decision, or at least a reasonable probability, that the asset would be sold. *Cf., List* v. *Fashion Park, Inc.*, 340 F.2d 457 (2d Cir. 1965), *cert. denied*, 382 U.S. 811 (1965); *James Blackstone Memorial Library Ass'n* v. *Gulf, Mobile & Ohio R.R. Co.*, 264 F.2d 445 (7th Cir. 1959), *cert. denied*, 361 U.S. 815 (1959).

In the instant case, Judge Pollack found that during the relevant period there was neither a decision nor a reasonable

probability that the BAR would be sold (Jt. App. C-13).* His holding that Bangor Punta's registration statement was nonetheless "unintentionally in error" was expressly based upon the unusual, but entirely proper, method of reporting the carrying value of the BAR on Bangor Punta's balance sheet, *i.e.*, the use of a 1965 appraisal.** Judge Pollack stated:

> "In so holding [that Bangor Punta's registration statements was deficient] especial note is taken of the unique 'valuation' nature of the $18.4 million figure at which the BAR interest was carried on Bangor Punta's books. The present conclusion is not necessarily to be taken as applicable in cases where book carrying figures are in accordance with principles of conventional transactional accounting or where circumstances might otherwise be different." (Jt. App. C-15-16).

When the highly unique factual circumstances of the instant case are coupled with Judge Pollack's express findings of good faith and absence of any intention by Bangor Punta to mislead the public (Jt. App. C-12-14), sufficiently exceptional circumstances are presented, even under the very test suggested by the Commission, to permit the District Court to exercise its discretion to deny injunctive relief.

The Commission's petition herein not only ignores the unique factual circumstances involved in this case but attempts to attack Judge Pollack's findings of good faith by

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* As Judge Pollack found, Bangor Punta's management, "consistent with the dictates of prudence . . . insisted on consideration and study of alternatives," including various methods of possible disposition of the BAR under which substantial tax benefits of up to $17.7 million might be obtained. (Jt. App. C-12). Indeed, the evidence showed that both Bangor Punta's Chairman of the Board, Nicolas M. Salgo, and its President, David W. Wallace, strongly opposed the sale to Amoskeag up until the eve of its consummation in October, 1969.

** Because this appraisal value was used, Judge Pollack concluded that disclosure of a proposal to purchase the BAR at a substantially lower figure was required irrespective of whether or not there was at the time a reasonable probability that the proposal would ultimately be accepted.

citing language from Judge Timbers' opinion to the effect that Bangor Punta's conduct was "unreasonable" and "reckless". These citations, however, merely serve to highlight the inherent inconsistencies in Judge Timbers' analysis, for at other places in his opinion Judge Timbers characterizes Bangor Punta's conduct as "negligence" (Jt. App. H-56) and expressly, although somewhat grudgingly, accepts all of the findings of fact made by Judge Pollack, necessarily including his findings of good faith (Jt. App. H-37, 79).

Moreover, Judge Mansfield, joined in substance by Judge Gurfein (Jt. App. H-97-98), laid to rest any possible claim that Bangor Punta acted other than in good faith, stating:

> "The dissent's description of BPC's conduct as 'most flagrant,' its characterization of the district court's action as an 'abuse of discretion,' and its portrayal of our decision as a 'mischievous precedent,' simply ignore undisputed contrary findings of fact, which are fully supported by more than ample credible evidence. Such comments sacrifice controlling evidence and governing legal principles to insatiable zeal for use of an unjustified remedy, all in the name of vigorous enforcement of federal securities laws." (Jt. App. H-117; see also Jt. App. H-117-123).

Thus, no amount of rhetoric, either in Judge Timbers' opinion or by the Commission, can change the fact that this case involves a single unintentional violation of the securities laws, arising in a quite unique factual situation, by a defendant which at all times acted in utmost good faith with no intention to mislead the public. These were Judge Pollack's findings, and they were expressly affirmed by the Second Circuit. Under such circumstances, as Judges Gurfein and Mansfield concluded, Judge Pollack's denial of the Commission's request for injunctive relief was fully within the proper exercise of his discretion. See, *e.g.*, *United States* v. *W. T. Grant Co.*, *supra*; *SEC* v. *Manor Nursing*

Centers, Inc., 458 F.2d 1082, 1100-1 (2d Cir. 1972); *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1306-7 (2d Cir. 1971); *SEC* v. *Culpepper*, 270 F.2d 241, 249-50 (2d Cir. 1959); and *SEC* v. *Harwyn Industries Corp.*, 326 F. Supp. 943, 955-7 (S.D.N.Y. 1971).

Lastly, the Commission expresses fears that the statement in Judge Pollack's opinion that the Commission failed to establish that Bangor Punta had "a propensity or natural inclination to violate the securities laws" will be interpreted by other courts in a manner which will "seriously lessen the availability and hence the effectiveness of Commission injunctions as a major tool for protecting public investors against securities frauds."*

Although Judge Pollack's decision is now more than two years old, the Commission cannot point to a single decision in which it has been denied injunctive relief based upon the feared phrase in his opinion. Moreover, the majority opinions of Judges Gurfein and Mansfield on appeal make abundantly clear that this case is not to be construed in any way as changing existing standards for injunctive relief (Jt. App. H-98, 121).** Thus, the fears expressed by the Commission herein are groundless.

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* It is ironic that the Commission now objects to the District Court's use of the word "propensity", which had its origin in this action in the complaint which the Commission filed to initiate the action. (SEC Complaint, ¶ 18, Appendix in Court of Appeals, Vol. I, p. 199A).

** Indeed, in its brief in opposition to a motion to dismiss filed by certain defendants in *SEC* v. *Allegheny Beverage Corporation* (D.D.C. Civ. No. 932-73), one of the pending actions cited in a footnote at p. 13 of the Commission's petition herein, the Commission expressly recognized that the majority opinions do not reflect any change in existing standards. The Commission stated:

> "Defendants also rely on *Securities and Exchange Commission* v. *Bangor Punta Corp.*, 331 F. Supp. 1154 (S.D.N.Y. 1971). As the defendants indicate, this case was affirmed by a majority of a panel of the Court of Appeals for the Second Circuit . . . However the majority opinion did not regard its decision as changing the standard from one of 'reasonable likelihood' to 'natural inclination and propensity'. The court stated: 'We emphasize that we are not in the least interested in limiting the basis for an SEC injunction as a matter of general rule'." (Citations omitted.)

Conclusion

For the foregoing reasons, respondent prays that the Commission's petition for a writ of certiorari be denied.

Respectfully submitted,

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September 13, 1973.

REPLY BRIEF OF PETITIONER

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OCTOBER TERM, 1973

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

Respondent emphasizes (Br. in Opp., pp. 1, 5) the finding of the district court that Bangor Punta acted in complete good faith with no intent to violate the securities laws and states that that court's decision was affirmed by the court of appeals in all material respects (Br. in Opp., p. 6). The court of appeals, however, did not affirm that finding. To the contrary, in the portion of its opinion dealing with the claims of Chris-Craft against Bangor Punta, as to which that court was unanimous, it stated (J. App. H47-H48):

> We believe that the officers of BPC [Bangor Punta] greatly transgressed their allowable area of discretion in not disclosing the BAR [Bangor and Aroostock Railroad] negotiations and other circumstances reflecting the value of the BAR. The officials

> in charge of the exchange offer were well aware of the discussions with Amoskeag and the activities of the special BAR committee. They also were aware of all the other circumstances that indicated that the book value of the BAR was deceptive and unrealistic. Their judgment not to reveal basic information about the then current status of the BAR holdings clearly was unreasonable. They showed reckless disregard for the import of their activities concerning the BAR. They knew that the book value of the BAR set forth in the registration statement was no longer realistic. Considering the totality of the facts and circumstances, they failed to discharge their clear duty of proper disclosure.

Respondent also states (Br. in Opp., p. 9) that Bangor Punta's violation was a "single unintentional violation" in which it acted in "utmost good faith with no intention to mislead the public." The foregoing statement of the court of appeals refutes that claim, which also is inconsistent with the fact that three days before this violation Bangor Punta had consented to an injunction against other securities law violations in connection with the same proxy contest (Pet. 3-4). It was in the light of that earlier injunction that the Commission alleged in its complaint that Bangor Punta had a "propensity for violating the securities laws." Respondent suggests (Br. in Opp., p. 10 n. *) that this allegation indicated that the Commission assumed that such a "propensity" was a prerequisite to an injunction. In fact, however, that "propensity" highlighted the need for an injunction and demonstrated that it should be broad enough to protect the public against different types of violation.

Respectfully submitted.

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